BlackRock

August 2, 2019

Submitted via electronic filing: www.sec.gov/rules/proposed.shtml

Ms. Vanessa Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: Notice of Filing of a Proposed Rule Change to Introduce a Liquidity Provider Protection on EDGA, Release No. 34-86168; File No. SR-CboeEDGA-2019-012

Dear Ms. Countryman:

BlackRock, Inc. (together with its affiliates, "BlackRock")[1] appreciates the opportunity to comment on the above referenced rule proposal to introduce a Liquidity Provider Protection ("LP2") on the Cboe EDGA Exchange, Inc. ("EDGA" or the "Exchange"). As proposed, the rule would subject a delay mechanism of four milliseconds on all executable liquidity removing orders arriving on EDGA, inclusive of cancel and cancel/replace messages on such orders. The purpose of LP2 is to protect liquidity providers from strategies, such as cross-asset latency arbitrage, and thereby enable those liquidity providers to make better markets in equity securities traded on the Exchange.

BlackRock supports changes which promote fair and orderly markets and benefit the functioning of the entire equity market ecosystem, inclusive of both individual stocks and ETFs. We appreciate Cboe's efforts to innovate and improve liquidity provision in the marketplace. However, we urge the Commission not to approve the proposal as we believe that it will introduce needless complexity[2] and have a detrimental effect on US equity markets.

Although EDGA likens the functioning of LP2 to speed bumps which have been adopted by other exchanges, existing delay mechanisms are materially different because they are equally applied to all incoming messages from any market participant. EDGA, by contrast, proposes to implement an *asymmetric* delay which is imposed selectively on market participants who submit liquidity removing orders. There is no precedent for asymmetric speed bumps in the

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[1] BlackRock is one of the world's leading asset management firms. We manage assets on behalf of institutional and individual clients worldwide, across equity, fixed income, liquidity, real estate, alternatives, and multi-asset strategies. Our client base includes pension plans, endowments, foundations, charities, official institutions, insurers, and other financial institutions, as well as individuals around the world. BlackRock is the investment adviser to the iShares family of exchanges-traded funds ("ETFs"). BlackRock also advises non-US ETFs.

[2] Regulation should promote innovation and encourage fair competition while moderating increasing complexity. BlackRock, *ViewPoint – Mark-to-market structure: An end-investor perspective on the evolution of developed equity markets*, (Feb. 2019), available at https://www.blackrock.com/corporate/literature/whitepaper/viewpoint-mark-to-market-structure-an-end-investor-perspective-on-the-evolution-of-developed-equity-markets.pdf.

US equity market.[3] As such, the proposed LP2 mechanism should be subject to careful and deliberate scrutiny, given the magnitude of impact that an asymmetric delay can introduce.

EDGA's LP2 would confer significant advantages to liquidity providers without requiring any additional market making obligations in return. This discriminates unfairly against liquidity removers who are exposed to both increased adverse selection and the potential to execute at stale prices after the 4-millisecond delay. For example, consider a scenario where an investor seeks to sell at the EDGA bid. If the market moves lower, the liquidity provider would be able to remove their bid, leaving the investor with the undesirable prospect of having to transact at a worse market price. Conversely, if the market moves higher, the investor, being unable to cancel their liquidity removing order, would be forced to trade-through better prices and execute against a stale quote.[4] These outcomes are stacked in favor of the liquidity provider, as LP2 both protects them from latency arbitrage and generates latency arbitrage opportunities for them.

EDGA believes that LP2 would "enable liquidity providers to increase market quality by maintaining tighter spreads, longer inside quote durations, and posting larger size."[5] This benefit is unlikely to be realized, however, as the design of the speed bump disincentivizes market participants from improving upon the best bid or offer displayed on away markets. If liquidity providers post a higher bid on EDGA than the best bid available from other markets, then they will increase the likelihood that their orders jump to the front of the queue and are filled first, ahead of other bids in the marketplace. When this happens, the delay no longer functions to help liquidity providers selectively avoid executions. The benefits of LP2 are optimized when liquidity providers match or join an existing quote, not when they quote at tighter spreads. Further, liquidity providers at exchanges without asymmetric delays are likely to bear the cost of increased adverse selection, which will cause spreads to widen at those venues. The net impact is an overall deterioration of market quality and increased costs for investors.

Academic studies of the asymmetric delay introduced by the TSX Alpha exchange in Canadian equity markets reinforce this expectation. TSX "Alpha's time spent at the NBBO reduces from 60% to 36% immediately after the introduction of the speed bump, consistent with liquidity suppliers' desire to harness information from order flow on other venues – quoting alone at the NBBO removes the value of the speed bump."[6] While there are structural differences between Canadian and US markets, we believe that the experience from TSX Alpha is informative for the current proposal because "symmetric versus asymmetric applications of such delays will likely result in differing outcomes for market quality … and can generate market wide

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3 An asymmetric speed bump proposal from the Chicago Stock Exchange, Inc. was subsequently withdrawn after the Commission stayed staff approval to review the delegated action.

4 In this situation the trade-through would stand as it occurs under a valid exception in Rule 611(b)(8) – The trading center displaying the protected quotation that was traded through had displayed, within one second prior to execution of the transaction that constituted the trade-through, a best bid or best offer, as applicable, for the NMS stock with a price that was equal or inferior to the price of the trade-through transaction.

5 *See* Notice of Filing of a Proposed Rule Change to Introduce a Liquidity Provider Protection on EDGA, SEC Release No. 34-86168, (Jun. 20, 2019) available at https://www.sec.gov/rules/sro/cboeedga/2019/34-86168.pdf.

6 *See* Haoming Chen, Sean Foley, Michael Goldstein & Thomas Ruf, The Value of a Millisecond: Harnessing Information in Fast, Fragmented Markets (Nov. 18, 2017), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2860359.

consequences."[7] "[C]aution is warranted for proposals which lead to the provision of a systematic speed advantage to any class of participant – speed bump or otherwise."[8]

Investor confidence and market integrity may be severely eroded if market participants are forced to navigate a more complex landscape of contingent bids and offers. Approval of an asymmetric delay has the potential to open a Pandora's box of illusory quotes and phantom liquidity, akin to institutionalizing the practice of "last look".[9] Supporters of the LP2 proposal will assert that it is not equivalent to "last look" because liquidity providers have no knowledge of incoming orders. We agree that LP2 is different because it is also missing some of the attendant investor protections. For example, in "last look" markets investors can actively manage counterparty relationships to strike an appropriate balance among the inherent conflicts of interest. Further, counterparties can implement "last look" symmetrically to protect both liquidity removers and liquidity providers against adverse market moves. Such mitigating controls and prudential supervision are conspicuously absent from the EDGA proposal.

Given these concerns, if the Commission intends to approve the EDGA LP2 mechanism, we recommend that they do so on a pilot basis to limit its deleterious effects and enable the collection of empirical data for assessing its impact on market quality. Otherwise, we fear that asymmetric delay mechanisms would proliferate as other exchanges feel compelled to compete on the benefits given to liquidity providers.

Additionally, the inclusion of manual, non-protected quotations in the National Best Bid and Offer (NBBO) disseminated by the applicable Securities Information Processor introduces complications which require further clarification. The NBBO is an essential input for Rule 605 statistics, transactions cost analysis, pricing pegged orders, and compliance with the Order Protection Rule and Regulation SHO. The impact of using unprotected or potentially inaccessible quotes in these scenarios should be examined thoroughly. In fulfilling their best execution responsibilities, broker dealers may still feel obligated to consider the quotes on EDGA despite their non-protected status. As such, FINRA or the Commission should also clarify how market participants should interact with unprotected quotes in achieving best execution.

We thank the Commission for this opportunity to comment upon and express our reservations about the EDGA LP2 delay mechanism. BlackRock believes that disapproval of this proposal will help to promote fair and equitable principles of trade. We welcome any questions or further discussion on the views presented in this letter.

Sincerely,

Hubert De Jesus
Managing Director, Global Head of Market Structure and Electronic Trading

Joanne Medero
Managing Director, Global Public Policy

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7 *Id.* at 49.

8 *Id.* at 49.

9 Last look is a practice in some markets such as FX, where a market participant disseminates non-firm quotes to clients and upon receiving a request to trade against its quoted price, has a final opportunity to accept or reject the trade request.